IN THE

Supreme Court of the United States

OCTOBER TERM, A. D. 1949.

No. 728.

UNION BLEACHERY, *Petitioner*

v.

UNITED STATES OF AMERICA, *Respondent.*

On Petition for Writ of Certiorari to the United States Court of Appeals for the Fourth Circuit.

PETITIONERS' REPLY TO BRIEF FOR THE UNITED STATES IN OPPOSITION.

In the preparation of its petition for a writ of certiorari and the supporting brief, the petitioner followed the form of certain petitions that have been filed by others, and earnestly attempted to comply with the Rules of this Honorable Court. Therefore, this petitioner fails to understand in what respect its petition and brief in support thereof is in substantial disregard of Rule 38, paragraph 2,

as alleged by the respondent. Therefore, the petitioner prays that this Honorable Court will consider good intentions rather than results, substance rather than form, and that it will overlook such errors if any there be as alleged.

Although the petitioner urged in all proceedings and in this petition for writ of certiorari, with respect to property acquired before the basic date, that, for each of the years 1923 to 1928, inclusive, it is entitled to allowances for deductions of depreciation computed on the basis of the fair market value as of the basic date, which is either July 1, 1922 or March 1, 1913, whichever is determined by the Court, (Cf. Pet. Bf. 28-54) the respondent attempts to make it appear that the petitioner urges use of the fair market value as of July 1, 1922 only, as being the basic date. (Respondent's Bf., 2)

Although admitting that the Commissioner computed the allowances for depreciation on the book record of cost (beginning in 1904), and on the book record of cost of additions, and that, for the year 1923, the proper basis on which the petitioner is entitled to have its allowances for depreciation computed is the fair market value as of March 1, 1913, the respondent urges that "the Commissioner allowed reasonable depreciation deductions," that the petitioner "did not carry its burden of showing that the fair market value of the property owned on March 1, 1913 was in excess of the cost or book values," and that "both lower courts properly approved these allowances in the absence of proof establishing that the depreciation basis was too low." (Respondent's Bf. 2, 3) No such burden rested on the taxpayer. (Pet. Bf. 28-55)

Section 234 (R. 5-8) clearly provides without any exception, hindrance or aid of the taxpayer, that "(a) * * * there shall be allowed as deductions: * * * (7) A reasonable allowance for the exhaustion, wear and tear of property * * * In the case of property acquired before March 1, 1913, this deduction shall be computed upon the basis of its fair market value as of March 1, 1913." As the Com-

missioner is charged with the administration of the tax laws, the directive contained in section 234 is aimed at the Commissioner, and the use of the word "shall" precludes entertainment of the respondent's theory that the Commissioner might escape his duty unless the taxpayer is able to force him. (Pet. Bf. 28-55)

Pursuant to the provisions of section 250 of the appropriate revenue act, the Commissioner "shall" examine the return "as soon as practicable" after it is filed. "If the amount already paid exceeds the correct amount of the tax, the excess shall be credited or refunded to the taxpayer in accordance with the provisions of section 252. * * * If the amount already paid is less than that which should have been paid, the difference, * * * shall be paid upon notice and demand by the collector." (Pet. Bf. 81) Obviously, the correct net income and tax due can only be determined if the Commissioner determines allowances for depreciation in accordance with the provisions of section 234(a)(7). (Pet. Bf. 28-54)

Without regard as to whether the taxpayer aids or hinders, the Commissioner is under compulsion to determine the correct net income and tax due, at all times, within the prescribed period after the return was due to be filed, of five, four, three and two years, pursuant to the provisions of the Revenue Acts of 1921, 1924, 1926 and 1928, respectively, and continuously after the expiration thereof if, within such periods, the taxpayer has filed a claim for refund. (Pet. Bf. 85-91) Sections 234 (a)(7), 250 (b), and 252, Rev. Act of 1921; Sections 234 (a)(7), 274(a), and 281, Rev. Act of 1924; Sections 234 (a)(7), 274 (a), and 284, Rev. Act of 1926; and Sections 23(k), 57 and 322, Rev. Act of 1928. (R. 7-14) The statutory provision for the due filing of a claim for refund was for the purpose of putting the Commissioner on notice that he had not yet performed his duty and to extend indefinitely the period during which he is compelled to determine the correct net income and tax due. (Pet. Bf. 82) All grounds upon which the petitioner's suit was based were set forth in claims for refund as originally filed or as amended.

Although the Commissioner was under compulsion to determine a fair market value as of the basic date, and had available to him all books and records of the petitioner's business together with the evidence that was submitted at the trial, he did not make such determination. Such failure has destroyed any presumption of correctness that might otherwise have attached to the Commissioners determination, since his failure was deliberate, arbitrary and without rational foundation (*Russell* v. *Commissioner,* 45 F. (2d) 100, 103) and his determination and the decision of the lower courts sustaining it should be set aside. *Helvering* v. *Taylor,* 292 U. S. 507.

Upon consideration of the entire record and of the facts available it appears that the Commissioner was strongly opposed to the making of a determination of the fair market value as of the basic date. Notwithstanding that as of March 1, 1913, it was clearly apparent that there was much more property on hand than was reflected by the book record cost as of that date, the Commissioner's agents, Epps and Friend, testified, in effect, that they accepted without question the book record costs of plant and additions acquired in 1904 and subsequent years. Testimony of Epps: "I also made an examination of the books of account of these companies to ascertain the plant account as carried upon the books over the period 1904 through 1926." He also stated for computing depreciation, "The base is cost," meaning book record cost. (Def. Ex. E, pp. 82, 83) Testimony of Friend: "In computing depreciation allowed, I based the depreciation on the capital asset account as reflected by the books, that is, the gross asset account unreduced by the reserve for depreciation." The Commissioner and his agents would not have hesitated to make a determination of the actual costs had they thought that the book record costs were in excess thereof. Their failure to determine the actual costs cannot be said to result from failure of the taxpayer, who, prior to 1914, pursuant to a conservative policy generally followed by

industry before taxation became an important factor, did not enter in its property account all of the costs of capital items that were acquired. (Pet. Bf. 28-54)

In addition to its books and records, there was submitted in evidence the testimony of the plaintiff's witnesses, Jno. W. Arrington and John A. McPherson, both having the quality of experts with respect to that of which they testified, both testifying that the actual cost and the fair market value of the property acquired before March 1, 1913 is greatly in excess of the book record of cost as of that date. Although the book record cost of the property, less land, as of March 1, 1913 and as of July 1, 1922 is $428,895.48 and $1,374,860.99, respectively, calculations based on the testimony of the witnesses Arrington and McPherson and other facts establishes that the actual cost of such property on those dates is $1,172,658.25 and $2,118,623.76, respectively, and that the fair market value is $2,233,158.61 and $3,179,124.12, respectively. (Pet. Bf. 28-54) Therefore, if any burden rested on the petitioner to support its claims for refund, it appears that it fully met such burden. The petitioner could not force the Commissioner to consider such facts.

Mr. John T. Keenan, a witness for the United States, in a former action, *Union Bleachery* v. *United States*, # 3688, 75 F. (2d) 549, urged by respondent and held by the lower courts to be res judicata, of which the record was submitted in evidence by the United States as Defendant's Exhibit E, testified; "I am a valuation engineer, and have been employed by the Bureau of Internal Revenue for nine years. I knew the type of machinery employed by the Union Bleaching & Finishing Company in 1911. * * * I am familiar with the process employed * * * I was engaged in this business during the years 1917, 1918 and 1919. I was not at this plant * * * I called there occasionally * * * I could not give you an estimate of a fair market value of the Union Bleachery property on March 1, 1913. I know about the time when it was purchased. I would say it was very much

more valuable then in 1913, because they had done good work and had established a good reputation and were able to get business that would make good money. That would be my idea of the principal reason. The fact it was a going concern, all in one piece, and well laid out had something to do with it. * * * I am not in position to say how much more by percentages or otherwise it was worth in 1913." (Def. Ex. E, pp. 86-89) According to the respondent's own witness, the fair market value as of March 1, 1913 exceeded the actual cost. With the exception of having granted a small judgment, for the year 1918, based on amortization and not involving a fair market value as of March 1, 1913, that case was dismissed for want of jurisdiction, otherwise, the fair market value as of March 1, 1913 might have been then established.

The fact, appearing in the tax returns, in the revenue agents reports and other records, that the petitioner and its predecessor earned considerable net income and paid substantial amounts of income tax, each year, is in itself proof of a going concern value that attaches to and increases the value of the property. Considering that fact and the testimony of the expert witnesses, there is ample and substantial evidence of a fair market value considerably in excess of the book record costs as of the basic date. Such facts were alleged in claims for refund filed for each of the years, and the taxpayer met any burden resting upon it to prove those claims with respect to depreciation allowances being inadequate.

Although the provisions of section 204, of each of the Revenue Acts of 1924 and 1926, are independent of and bear no relation to the provisions of section 234 (a) (7) of each of those acts, the respondent erroneously urges that pursuant thereto the bases for depreciation as provided in section 204 are the same as the bases provided for in section 234 (a) (7) (Respondent's Bf. 4). There are no grounds for the respondent's contention. The subject matter of the said sections 204 are, as stated therein, "The

basis for determining the gain or loss from the sale or other disposition of property," such basis therein being provided for use in the "Determination of amount of gain or loss" as provided for in section 202 of the said Acts. In other words, section 204 provides the basis upon which depreciation will be based in determining the depreciated value of property as a part of the process in computing the gain or loss provided for in section 202. Whereas, the subject matter of section 234 (a) (7) provided the basis for computing depreciation deductions from income for the purpose of computing net taxable income. The determination of depreciation as provided for in the said sections are for different purposes of unrelated provisions of the 1926 and prior Revenue Acts.

It is reasonable to conclude that, if the Congress had intended to that the same basis should be used in computing depreciation as a deduction from income as the amount of depreciation to be considered in computing gain or loss from sales, that such provision would have been clearly made. However, in sections 23 (m) and 114, Revenue Act of 1928, for the first time in the legislative history of the revenue acts, the Congress clearly provided that the same basis should be used in computing depreciation as a deduction from income as when computing the depreciated cost when determining gain or loss resulting from the sale of property.

Upon erroneously assuming that allowances for deductions of depreciation from income should be computed upon the basis provided for in sections 203 and 204 of the Revenue Act of 1924 rather than as provided in section 234 (a) (7) of the Revenue Act of 1921, the respondent argues inversely that the said sections 203 and 204 "do not provide that the basis for depreciation in 1924-1928 is to be determined by reference to the law applicable for the year (1922) in which the reorganization took place," and, therefore, the court below did not bring itself into conflict with this Court's decision in *Reo Motors* v. *Comm.*, 338 U. S. 442.

The petitioner reiterates all it has set forth in its petition, and, with the exception of admissions favorable to the petition, denies all allegations, statements, theories and validity of argument presented by the respondent in its brief in opposition to this petition for a writ of certiorari.

The petition for a writ of certiorari should be allowed.

Respectfully submitted,

LEONARD MARSHALL
Attorney for the Petitioner.

May 25, 1950.